No. 18729

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

BANK OF AMERICA NATIONAL TRUST AND SAVINGS ASSOCIATION,

Appellant,

vs.

JAMES A. A. SMITH, Trustee in Bankruptcy of the Estate of Conair, Inc., a California corporation, bankrupt,

Appellee.

BRIEF OF APPELLEE.

QUITTNER, STUTMAN, TREISTER & GLATT,
GEORGE M. TREISTER,
639 South Spring Street,
Los Angeles 14, California,
Attorneys for Appellee.

Parker & Son, Inc., Law Printers, Los Angeles. Phone MA. 6-9171.

TOPICAL INDEX

TABLE OF AUTHORITIES CITED

Cases

Statutes

Textbooks

No. 18729

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

BANK OF AMERICA NATIONAL TRUST AND SAVINGS ASSOCIATION,

Appellant,

vs.

JAMES A. A. SMITH, Trustee in Bankruptcy of the Estate of Conair, Inc., a California corporation, bankrupt,

Appellee.

BRIEF OF APPELLEE.

Jurisdiction.

The Court has jurisdiction of this appeal under Section 24a of the Bankruptcy Act, 11 U. S. C. Sec. 47a.

Statement of the Case.

This is an appeal from an Order of the Honorable Harry C. Westover, United States District Judge, dated March 5, 1963 [Tr. 57-58],[1] which affirmed an or-

[1]To conform to the system adopted by appellant, references in this Brief to Volume I of the Transcript of Record (which contains the documentary matter) will be cited as "Tr." Citations to Volumes II and III containing the testimonial evidence will be designated as "R," with a reference to the page number as it appears in the typewritten reporter's transcript.

der of the Honorable Ray H. Kinnison, Referee in Bankruptcy, entered December 27, 1962 [Tr. 39-43].

Appellant filed its Second Amended Petition In Reclamation on July 6, 1962, seeking to recover the proceeds of certain accounts receivable which allegedly had been assigned to appellant by the bankrupt, but which had been collected by appellee-trustee in bankruptcy [Tr. 20-28]. To eliminate the necessity for complex evidence on the undisputed accounting phases of the case, appellant and appellee entered into a detailed stipulation of facts [Tr. 29-33] and a supplement thereto [Tr. 34-35]. These documents, together with appellant's pleading, framed the issues for the court's determination.

The matter was heard on September 27 and October 30, 1962, at which times certain evidence was introduced, both testimony and documentary exhibits. On December 18, 1962, the Referee rendered his memorandum opinion [Tr. 36-38], followed by the formal findings, conclusions and order on December 27, 1962 [Tr. 39-43]. He held, as indeed appellee had conceded, that appellant was entitled to reclaim the sum of $23,509.90, representing collections of accounts receivable by the trustee on invoices which had been assigned to appellant, and which arose as a result of the bankrupt's deliveries of merchandise to its customers before bankruptcy. He further held that the trustee was entitled to the sum of $21,554.66 collected by and in the possession of appellant, but representing merchandise delivered after bankruptcy and invoiced to the customers by appellee.

Appellant filed a timely Petition for Review insofar as the order was adverse to it [Tr. 45-47]. On March

5, 1963, the District Judge affirmed the Referee [Tr. 57-58].

Appellant filed its Notice of Appeal to this Court on April 4, 1963 [Tr. 60-61].

Statement of Facts.

On November 1, 1960, Conair, Inc. (sometimes referred to herein as the bankrupt), a California corporation engaged in the machine shop business, filed a petition under Section 322 of Chapter XI of the Bankruptcy Act, 11 U. S. C. Sec. 722. Appellee was appointed receiver the next day. Within the following two months, the arrangement failed, the court entered an adjudication, and appellee qualified as trustee in bankruptcy on January 4, 1961. In his latter capacity, as well as during the preceding receivership, he operated the bankrupt's business for a short time so as to be able to liquidate it on a going concern basis [Tr. 40, 53-54; R. p. 19].

The dispute in this case concerns the rights to collections made on certain accounts receivable allegedly assigned to appellant. While appellee concedes that the accounts belong to appellant to the extent that they are attributable to deliveries of merchandise made prior to bankruptcy, he claims all receivables generated during his operation of the business after the petition. Both types arose in the following manner: Basic contracts were entered into by the bankrupt with its customers covering work to be performed, in quantities as the customers might later order. Thereafter, the customers from time to time would issue job orders to the bankrupt calling for the manufacture of specific amounts of the product. When the work was com-

pleted and the product delivered, invoices for such deliveries would be sent to the customers [Tr. 30].

In September 1960, the bankrupt was indebted to appellant for $69,000.00 on unsecured loans. To put this debt on a secured basis, and to provide for its liquidation out of future business revenues, the bankrupt assigned to appellant the monies due or to become due under the basic contracts with its customers. As required by California Civil Code Sections 3017 *et seq.,* a "Notice of Assignment of An Account or Accounts" in general form was duly filed on September 22, 1960. Subsequently, the invoices for products delivered before bankruptcy were assigned by the bankrupt to appellant as they arose [Tr. 21, 27-28, 30].

When appellee assumed control after November 1, 1960, he filled certain job orders which were then on hand as a step in liquidating the assets of the estate. He did not know at that time that the basic contracts to which these job orders related had been assigned to appellant, nor did he intend to assume any of the bankrupt's executory contracts. Rather, he chose wherever possible to sell and deliver inventory on hand to customers who had placed job orders, since such a course naturally promised a greater realization than could be expected from a public auction of the physical inventory [Tr. 40-41; R. pp. 7-17, 95-96].

Appellee collected a total of $55,301.35 from customers whose basic contracts had been assigned by the bankrupt to appellant. Of this amount, $23,509.90 represents the proceeds of the bankrupt's assigned accounts receivable, *i.e.,* the proceeds of invoices created by the bankrupt through deliveries of its product before bankruptcy [Tr. 30-31]. Concededly, the funds to

this extent belong to appellant, and the courts below so held. The balance of appellee's collections arise out of deliveries made and invoices prepared by him after bankruptcy, *i.e.,* accounts receivable of the trustee as distinguished from accounts receivable of the bankrupt.

Appellant, too, has made certain collections. The monies received by it from all sources, totaling $44,345.32, reduced the principal amount of its claim against the bankrupt from $69,000.00 to $24,654.68 as of the time of the trial below. Included within these collections is the sum of $21,554.66 here in controversy.[2] This money in appellant's possession is attributable to invoices prepared and sent to customers by appellee after bankruptcy in connection with deliveries of merchandise made by him in his official capacity. The products thus delivered by the trustee were partially in process, partially finished goods, and partially in the raw materials stage when appellee first took possession of the bankrupt's assets at the time of the petition [Tr. 30-31]. The courts below ruled that these funds in the amount of $21,554.66 had derived from the trustee's receivables, rather than from the bankrupt's, and, therefore, belonged to the estate [Tr. 43, 57-58].

Statutes Involved.

Bankruptcy Act, Section 70a, 11 U. S. C. Sec. 110a:

> "The trustee . . . shall . . . be vested by operation of law with the title of the bankrupt as of the date of the filing of the petition initiating a proceeding under this Act. . . ."

---

[2]If, as the courts below have held, appellant is liable to return its collections to the extent of the $21,554.66, its present claim against the bankrupt will be correspondingly increased.

Bankruptcy Act, Section 70b, 11 U. S. C. Sec. 110b:[3]

> "Within sixty days after the adjudication, the trustee shall assume or reject any executory contract, including unexpired leases of real property: *Provided, however,* That the court may for cause shown extend or reduce such period of time. Any such contract or lease not assumed or rejected within such time, whether or not a trustee has been appointed or has qualified, shall be deemed to be rejected. A trustee shall file, within sixty days after adjudication, a statement under oath showing which, if any, of the contracts of the bankrupt are executory in whole or in part, including unexpired leases of real property, and which, if any, have been rejected by the trustee: *Provided, however,* That the court may for cause shown extend or reduce such period of time."

Bankruptcy Act, Section 70c, 11 U. S. C. Sec. 110c:

> "The trustee, as to all property, whether or not coming into possession or control of the court, upon which a creditor of the bankrupt could have obtained a lien by legal or equitable proceedings at the date of bankruptcy, shall be deemed vested as of such date with all the rights, remedies, and powers of a creditor then holding a lien thereon by such proceedings, whether or not such a creditor actually exists."

---

[3]Section 70b as set forth above reflects the statute as it existed during the period involved in this case. Effective September 25, 1962, Section 70b was amended in certain particulars not here material. Pub. L. 87-681, Sec. 9.

Questions Presented.

1. Will a trustee in bankruptcy, who chooses to fill purchase orders on hand solely as a means of liquidating the bankrupt's inventory, be deemed as a matter of law to have assumed without prior court approval the bankrupt's executory contracts under which the purchase orders were placed?

2. Only if the first question is answered in the affirmative: Does the assumption of the bankrupt's executory contracts with its customers also mean that the trustee as a matter of law is deemed to have assumed the executory agreement under which the bankrupt had assigned its future accounts receivable, when the assignee of those future accounts had no rights in the inventory used by the trustee in filling the purchase orders?

Summary of Argument.

The funds here in dispute represent only payments made by customers for merchandise delivered to them after bankruptcy by appellee in his official capacity. As of the date of the petition, the merchandise involved was in varying stages of completion. Regardless of its condition, however, appellant had no secured interest in nor lien upon it. Accordingly, the trustee's title to the inventory under Section 70a of the Bankruptcy Act was free and clear of any rights of appellant. Moreover, his status as a lien creditor under Section 70c of the Act was superior to appellant's position.

Nevertheless, appellant contends that it is entitled to the receivables created when the trustee delivered the inventory to customers after bankruptcy on job orders placed before bankruptcy. The theory in this

respect is that the trustee assumed the bankrupt's executory contracts, including its assignment to appellant of accounts receivable to arise in the future. For several reasons, however, the argument is untenable:

Appellee in this case certainly did not intend to assume any contracts, nor did he ask the court for authority so to do. Where possible, he filled job orders on hand solely as a means of liquidating the estate, selling the assets at what he believed would be the most favorable prices.

Executory contracts not specifically assumed by the trustee are deemed to be rejected under Section 70b of the Bankruptcy Act. While in unusual situations a trustee possibly might assume an executory contract without prior and express court approval, such a procedure is frowned upon. Plainly, an assumption without the court's consent is not to be implied from ambiguous conduct, particularly where, as in the present case, the result would be a detriment to the estate. A knowing conformity to the terms of a contract is not tantamount to adoption of it in the present context.

But even if it were found that the trustee had assumed the executory contracts between the bankrupt and its customers, it should not follow that he also assumed the executory contracts by which the bankrupt assigned to appellant the future receivables. The contracts under which the work was performed are separate and distinguishable from the contractual relationship between the assignor and assignee of the monies becoming due.

ARGUMENT.

A. Appellant Had No Secured Interest in the Physical Inventories Delivered by the Trustee in Creating the Accounts Receivable in Question.

All funds here in dispute represent payments made by customers for merchandise delivered to them after bankruptcy by the trustee in his official capacity. When appellee took possession of the bankrupt's business at the time of the petition, some of this inventory was in the finished goods stage; the balance was either work in process or in the form of raw materials, which required further manufacturing and other costs to complete. But appellant does not and could not contend that it ever had a lien or other security interest in the bankrupt's physical inventories, regardless of the degree of completion of any particular item. Although California law permits the creation of liens upon inventory under certain circumstances, *e.g.,* Civil Code Secs. 3030 *et seq.,* there was no attempt in the present case to finance in such a manner.

Accordingly, by virtue of Section 70a of the Bankruptcy Act, 11 U. S. C. Sec. 110a, the trustee took title to the inventory on the date of the petition free and clear of any rights in appellant's favor. His position in this respect, moreover, was bolstered by the strong-arm clause of Section 70c of the Act, 11 U. S. C. Sec. 110c. The clause in effect makes bankruptcy operate as a judicial seizure of the debtor's assets. A trustee is vested as of the moment of the petition with all the rights, remedies and powers of a levying creditor. He prevails over other claimants who ob-

tain their rights or perfect their secured interests after the lien of Section 70c attaches.

See generally, 4 Collier on Bankruptcy, pp. 1424-1425.

Appellant apparently does not dispute appellee's position up to this point. If the trustee had disposed of the inventory in any manner except to those customers who had placed job orders with Conair, Inc. before bankruptcy, the proceeds of his sales concededly would belong to the estate. And this would be true even though the persons purchasing the inventory from the trustee subsequently retransferred it to the same customers with whom appellee dealt directly in this case.

Nevertheless, appellant claims the proceeds of the trustee's sales on the theory that by filling job orders appellee necessarily assumed the bankrupt's executory contracts, including the contracts by which future revenues were assigned to appellant. This position is untenable as will be demonstrated below.

B. Appellee Did Not Assume the Bankrupt's Executory Contracts With Its Customers.

When, on the date of the petition, either the bankrupt or the other party has not fully performed under a pending contract, the trustee is confronted with the alternatives of assuming or rejecting the agreement. Section 70b of the Bankruptcy Act, 11 U. S. C. Sec. 110b, provides in part:

> "Within sixty days after the adjudication, the trustee shall assume or reject any executory contract. . . . Any such contract . . . not assumed or rejected within such time . . . shall be deemed to be rejected."[4]

---

[4]Section 70b also requires the trustee to file a report within sixty days stating which executory contracts have been rejected.

As the leading treatise on the law of bankruptcy points out, this provision

> "makes it [the trustee's] duty within a prescribed period of time either to assume or reject, without, however, attaching any immediate sanction to a failure to elect except the operation of a conclusive statutory presumption that such failure amounts to a rejection. The real sanction is an indirect one, namely surcharge . . . if it is shown that the trustee's inactivity resulting in rejection constituted . . . neglect. . . ."
>
> 4 Collier on Bankruptcy, pp. 1353-1354.

Certainly, appellee never intended to assume any executory contracts, nor did he request the Referee for authority to do so. Wherever possible, however, he chose to sell and deliver inventory on hand to those customers who had placed job orders. For this means of liquidating the assets of the estate naturally prom-

---

Failure to comply in this respect, however, has no direct legal consequences. 2 Remington on Bankruptcy, pp. 617-618, comments as follows on this provision: "While §70(b) requires the trustee to file a list of executory contracts of the bankrupt stating which he has rejected, it appears that this is primarily a report, and effective rejection can already have taken place either by affirmative notice to that effect or by failure to assume the contract within the time prescribed for adopting it."

It is entirely misleading for appellant to suggest that Section 313(1) of Chapter XI, 11 U.S.C. Sec. 713(1), has anything to do with this case (Op. Br. p. 16). That section provides that upon the filing of an arrangement petition, the court may permit rejection of an executory contract after notice to the other contracting party. But failure to reject under Section 313(1) does not mean that the debtor or receiver has assumed the contract. On the contrary, executory contracts in Chapter XI may be rejected at any time before confirmation of the plan; it is not uncommon for the plan itself to provide for rejection. Bankruptcy Act, Sec. 357(2), 11 U. S. C. Sec. 757(2). And where, as here, bankruptcy supersedes the Chapter XI proceeding, Section 70b comes into play and Section 313(1) has no applicability at all.

ised a greater realization than would a public auction [Tr. 40-41].

It should be emphasized that filling a job order, as appellee did in certain instances, was not a full compliance with the basic contract under which the order was placed. The basic contracts, of course, called for deliveries to be made over considerable periods of time and in quantities beyond appellee's ability to meet. What occurred in the present case is analogous to the situation of a trustee who temporarily occupies premises leased to a bankrupt. Absent an express, intentional assumption of the lease with court approval—a decision which involves the undertaking of any long-term liabilities—the trustee is not deemed to have adopted the contract. Rather, his conformity to the lease terms makes him liable to pay the reasonable value of the use only for the period he retains possession. While such value is normally measured by the rent reserved in the lease, it does not follow that the trustee assumed the contract itself.

See 4 Collier on Bankruptcy, pp. 1374-1376.

Yet appellant attempts to spell out assumption of executory contracts solely from appellee's course of conduct in delivering inventory in fulfillment of orders on hand. There is no contention that the court expressly authorized the alleged assumptions; indeed, appellant denies that such permission is required (Op. Br. p. 11). In this connection, however, appellant errs by failing to distinguish between the court's supervisory

responsibilities over rejections of executory contracts, on the one hand, and assumptions on the other. As Collier states:

> ". . . it can not be considered as the intent of the Act that the trustee in order to *reject* an executory contract should first apply to the bankruptcy court and act by express order of the court. It may be safe and wise to do so, but it is not a legal prerequisite. . . .
>
> "The situation is different as to *assumption* of 'executory' contracts. Section 70b does not require the trustee to state which contracts he assumed. The reason for this differentiation is certainly not that it is of less importance. . . . On the contrary, the relative importance may be even greater. In this connection the principle . . . that an assumption of liabilities results in an increased charge to the estate of expenses enjoying the first rank of priority adds significance to the silence of § 70b regarding the report of contracts *assumed* by the trustee. The general rule that economy of administration calls for close, strict, and active control by the court of all administrative expenditure seems to lead to the conclusion that it is improper for a trustee to assume executory contracts on his own responsibility. He should consider the advisability of assuming a contract according to this best judgment and give the court all the benefit of his practical experience, if any. But the proper procedure is for the trustee to apply to the court for an order authorizing him to assume the contract if this is what his judgment advises him is the proper course. The court should pass upon

his application after notice to and a hearing of creditors and probably also the other party to the contract.

"In deciding whether or not a contract should be assumed the prospective benefit to the estate is an important, if not the decisive, consideration. But it should not be overlooked that normally such assumption entails the assumption of liabilities and in this connection it should be carefully considered whether or not the estate, either due to the assumption of the contract or possibly with the help of other available funds, is financially in a position to accept liabilities as a first charge on the estate."

4 Collier on Bankruptcy, pp. 1357-1359.

By the foregoing standards, obviously, appellee could not have validly assumed contracts in this case regardless of his intention, since he received no permission from the court to do so. The treatise's view is supported by *In re Philadelphia Penn Worsted Company,* 278 F. 2d 661 (C. A. 3, 1960), where, although a receiver had sought leave to assume an executory contract, no order was entered by the Referee. In finding no assumption, the opinion stated at page 665:

"The bankruptcy court's approval of the petition was essential in order to constitute a valid assumption of appellants' contract."

In re Forgee Metal Products, 229 F. 2d 799 (C. A. 3, 1956), cited by appellant, actually supports the above quotation from Collier. In that case, it was the trustee who contended he had adopted a contract within the period prescribed by Section 70b. Upholding this

argument, the Third Circuit pointed out that the assumption had been specifically approved "by order of the bankruptcy court which had the final determining authority of whether the contract should be so assumed." 229 F. 2d at 802.

Similarly, in *In re Swindle,* 188 F. Supp. 601 (D. Ore., 1960), which appellant refers to, the court expressly authorized the assumption of the contract.

See, also, *In re Public Ledger,* 63 F. Supp. 1008, 1015-1016 (E.D. Pa., 1945), rev'd on other grounds, 161 F. 2d 762; and *In re Schenectady Ry. Co.,* 93 F. Supp. 67, 69 (N.D. N.Y., 1950), discussed below in this Brief.

The same rule requiring advance court approval seems to have been applied in equity receivership proceedings before the amendments to the Bankruptcy Act of 1938. *Pacific Western Oil Co. v. McDuffie,* 69 F. 2d 208 (C. A. 9, 1934), *cert. den.* 293 U. S. 568, arose out of the Richfield Oil Company receivership. The question was whether the receiver, by continuing to purchase petroleum products from the appellant under contracts which were pending on the date of the petition, had assumed those contracts in their entirety. As in the present case, the appellant argued that the apparent adoption of the contracts for some purposes necessarily resulted in an assumption of all of the contractual burdens. This Court held that there had been no assumption:

> "It is a general rule that a receiver does not affirm and adopt an existing contract merely by taking possession of the property to which it relates along with other property of the estate; likewise, he

> may, with the approval of the court, perform some part of the contract, experimentally, or pending his election to adopt or reject it, without being or thereby becoming bound by its terms. It is not the rule that the contract is binding on the receiver until renounced. *In order for a receiver to become bound by a contract, he must positively indicate his intention to adopt it; the receiver is not bound until he has affirmed it and assumed its burdens under the direction of the court.*" 69 F. 2d at 213. (Emphasis added.)

Even where specific court authority in advance has not been required, the least the decisions have demanded as a condition of finding an assumption is an unambiguous declaration of the trustee's intent. *In re Luscombe Engineering Company,* 268 F. 2d 683 (C. A. 3, 1959), is the case closest on its facts to the present one. Insofar as is material here, the bankrupt was a subcontractor of Chrysler Corporation in connection with certain work for the United States. To finance its operations, the bankrupt had borrowed from the bank, assigning the monies to become due under the subcontract as security. When bankruptcy occurred, there were on hand certain tools and dies which had been made and used on the Chrysler subcontract and which were to be sold to Chrysler at the conclusion of the job. The trustee delivered these to Chrysler for the same price as called for by the subcontract and "in accordance with" that agreement. The lender asserted that this course of conduct was tantamount to assumption of the contract, and that the trustee was therefore bound to honor the bankrupt's assignment of the monies becoming due.

The Third Circuit rejected the argument and held that the proceeds of the tools and dies belonged to the bankrupt estate. The language of the opinion applies with great force to the present case:

> ". . . for a trustee 'to knowingly conform to the terms of a contract . . . is quite different from its assumption'. In re Schenectady Ry. Co., D.C.N.D.N.Y. 1950, 93 F. Supp. 67, 69. Accord, In re Public Ledger, D.C.E.D. Pa. 1945, 63 F. Supp. 1008, reversed on other grounds, 3 Cir., 1947, 161 F. 2d 762.
>
> "It is to be emphasized that we have here no express or even clearly implied assumption of a bankrupt's contract. The claimant's argument at most suggests ambiguous conduct by trustee and contractor which makes at least as much sense interpreted as a new contract as it does interpreted as an assumption of the old. In such circumstances it becomes significant that Section 70, sub. b of the Bankruptcy Act contemplates, though it may not unvaryingly require, an affirmative statement of assumption if a trustee proposes to assume the bankrupt's contracts. That section also provides explicitly that, absent assumption or rejection, a contract is deemed rejected. We think the sense of this is that rejection is to be inferred unless assumption is satisfactorily proved. Fletcher v. Surprise, 7 Cir., 1950, 180 F. 2d 669. This is in keeping with the recent admonition of this court in In re Forgee Metal Products, 1956, 229 F. 2d 799, 802, stressing the desirability and the importance of clear and express assumption of a bankrupt's contracts by the trustee, if such a course is intended.

> "There is an additional consideration which should make a court reluctant to imply assumption of any of the contracts here, unless the acts of the parties cannot fairly be interpreted any other way. That is the fact that it could be of no advantage to the bankrupt estate for the trustee to assume the old contracts rather than making new bargains for the disposal of the tools and manufactures on hand. . . . Assumption of the old contracts would not be of any greater advantage to Chrysler . . . but it would divert the proceeds from the bankrupt's estate to a particular secured creditor. We should not be eager to utilize any ambiguity in what the parties have said to give their transactions a significance they could not reasonably have intended if they had thought about it." 268 F. 2d at 686-687.

The last paragraph of the foregoing quotation sets forth the rule that assumption of a contract will not be implied—indeed will not be permitted by the court—where the result would be a detriment to the estate. If sustained, however, appellant's contentions and claim do cause such a detriment. For as seen at the outset, the inventory taken into possession by appellee at bankruptcy was free and clear of all liens and secured interests. Any assumption of the bankrupt's contracts which could have the effect of transferring to appellant the proceeds of the sales of the inventory, obviously would mean a loss to the estate in an amount equal to the value of the merchandise involved [Tr. 41]. Under such circumstances especially, assumption cannot be implied from appellee's conduct in this case.

It is also interesting to note that in the *Luscombe* case, as in the present one, the lender had no security interest in the physical assets as distinguished from an assignment of the receivables generated after bankruptcy through sale of those assets. The District Judge, whose decision was affirmed by the Third Circuit, said in this connection:

> "The government and the bank [lender] have sought to place on all these transactions a strained construction in order, in effect, to convert their security interest in the contract proceeds into what would amount to a lien on tangible goods. In this the law and the facts do not support their efforts. . . . The . . . Code . . . provided a convenient method of establishing a lien on the goods more than a year before the bankruptcy. The bank could have taken advantage of its terms, but did not. The courts cannot now do this for these claimants."
>
> *In re Luscombe Engineering Company,* 163 F. Supp. 706, 712 (E.D. Pa., 1958).

Actually, in those situations where a claimant does have a security interest or lien upon assets taken into possession by a trustee, it is unnecessary to analyze the case in terms of assumption of an executory contract. For under such circumstances, the creditor is secured. The trustee must either pay him in full out of the proceeds of the security, or restore the collateral in kind, even though the executory contract is rejected. It was thus superfluous to refer to Section 70b of the Bankruptcy Act in *In re Forgee Metal Products,* 229 F. 2d 799 (C.A. 3, 1956) and *In re McCormick*

Lumber & Mfg. Corporation, 144 F. Supp. 804 (D. Ore., 1956) (liens of conditional sales contracts), and in *In re Swindle,* 188 F. Supp. 601 (D. Ore., 1960) (lien of purchase money mortgage). If appellant here had held a lien upon the bankrupt's inventory, appellee would not question the claim to the monies received from the sales of that merchandise.

Appellant seems to rely principally on *In re Italian Cook Oil Corp.,* 190 F. 2d 994 (C. A. 3, 1951), *In re DeLong Furniture Co.,* 188 Fed. 686 (E.D. Pa., 1911) and *In re Public Ledger,* 161 F. 2d 762 (C. A. 3, 1947), but these are not good authority for its position. In *Italian Cook Oil,* a case arising under Chapter X of the Bankruptcy Act, trustees delivered merchandise in fulfillment of a contract of the debtor, the proceeds of which they knew had been assigned to a bank. The court held that by assuming the contract with the customer under Section 70b of the Act, the trustees also became bound to honor the assignment. The soundness of this conclusion as an original proposition will be considered below in this Brief under Heading C. In any event, however, the decision is distinguishable.

Unlike the present case, it was conceded in *Italian Cook Oil* that the trustees had assumed the debtor's contract. The court stated as a fact—not as a legal conclusion—that "The trustees proceeded to assume the contract. . . ." 190 F. 2d at 996. The question only involved the legal effect of the admitted assumption insofar as the assignment of the proceeds was concerned. Here, on the other hand, appellee denied that he assumed any contracts and the courts below so found as a fact on substantial evidence.

In *Italian Cook Oil,* moreover, the trustees knew of the assignment to the bank at all material times; indeed, there was some indication that the trustees intended to assume the assignment agreement as well as the contract itself, since they appear to have recognized the assignee at first by sending to it the relevant bill of lading and shipping documents.

But to whatever extent *Italian Cook Oil* might suggest that a trustee can assume an executory contract by performance under it, without an actual intention to do so, the case is inconsistent with, and accordingly superseded by, the later decision of the same court in *In re Luscombe Engineering Company, supra.* There, as has been seen, the Third Circuit in finding no adoption, observed that "for a trustee 'to knowingly conform to the terms of a contract . . . is quite different from its assumption'." 268 F. 2d at 686. Significantly, the *Luscombe* opinion did not refer to nor cite *Italian Cook Oil,* a circumstance which permits the inference that the earlier decision has little value as precedent.

Finally, *Italian Cook Oil* was demonstrably incorrect in its basic premise that Section 70b of the Bankruptcy Act had any applicability at all. The case arose under Chapter X, and the section in question does not apply to corporate reorganizations because of other conflicting provisions of the Act.

Title Insurance & Guaranty Co. v. Hart, 160 F. 2d 961 (C. A. 9, 1947), *cert. den.,* 332 U. S. 761;

6 Collier on Bankruptcy, p. 689, n. 49.

In re DeLong Furniture Co., 188 Fed. 686 (E.D. Pa., 1911), also is inapposite here. While the opinion is so cryptic that the facts of the case cannot be determined, it is clear that the trustee there, as in *In re Italian Cook Oil Corp., supra.,* admitted the assumption of the contract. The issue related only to the effect of the assumption on the previous assignment of the proceeds.

Although *In re Public Ledger,* 161 F. 2d 762 (C. A. 3, 1947), contains some language favorable to appellant's present position, the case seems to have been overruled insofar as it is here in point. At least, it is irreconcilable with the subsequent *Luscombe* decision of the Third Circuit. The heart of the *Public Ledger* case from appellant's standpoint is the statement in the opinion that:

> "it makes little difference . . . whether the trustees expressly assumed the contract or merely knowingly conformed to its terms." 161 F. 2d at 767.

But twelve years later in the *Luscombe* case, as quoted above, the same court clearly held that a knowing conformity to the contract is *not* tantamount to its assumption. In so holding, moreover, the decision cited the District Judge's ruling in *In re Public Ledger,* 63 F. Supp. 1008 (E.D. Pa., 1945), noting that it had been "reversed on other grounds." The lower court's opinion which was thus approved had stated:

> ". . . even had the Trustees adopted the . . . contract, it would have been invalid because it

> lacked an order of the court authorizing the same." 63 F. Supp. at 1016.

Similarly cited by the Third Circuit as authority in its *Luscombe* decision was *In re Schenectady Ry. Co.,* 93 F. Supp. 67 (N.D.N.Y., 1950). In that case, a District Court had held that there was no assumption of a labor contract by a Chapter X trustee, saying:

> ". . . the Trustee could not make such obligation his own which might seriously encumber the assets without the consent and approval of the Court." 93 F. Supp. at 69.

It seems plain, therefore, that appellant can derive no comfort from the decision of the Court of Appeals in *In re Public Ledger.* For further criticism of the case, see 4 Collier on Bankruptcy, pp. 1358-1359, nn. 30b, 30c, 30d.

Finally, appellant's reliance on *In re Tidy House Products Co.,* 79 F. Supp. 674 (S.D. Iowa, 1948), is misplaced. The case involved a bankrupt which had acquired certain rights in a trade name and trade mark under a contract calling for royalty payments. The trustee was denied permission to transfer the contract rights free of the obligation to pay royalties. It was held merely that if the trustee desired to assume the contract's benefits, so that he could sell them for the estate, he must also assume its burdens.

C. Even if Appellee Assumed the Bankrupt's Executory Contracts With Its Customers, He Did Not Assume the Contracts by Which the Receivables Were Assigned to Appellant.

Appellee submits that even if he had intentionally assumed the bankrupt's contracts with its customers, it does not follow that he also assumed the agreements which assigned the proceeds to appellant. The notion that a trustee adopts a contract "cum onere" is an oversimplification as appellant attempts to apply it. The fallacy is in the premise that the assignment is a burden of the original contract, when, to the contrary, the assignment is itself a separate contract.

In other words, appellant errs by failing to recognize the fact that the transaction in the present case involves not merely two parties; rather it is three-cornered. In the contract which appellee is said to have assumed, the subject matter and the parties differ from the contract upon which appellant must truly rely. The former involved the bankrupt and its customer, and related to the sale and purchase of inventory. The latter involved the bankrupt and appellant, and related to the transfer of the account receivable to arise from the sale to the customer. Nothing in Section 70b of the Bankruptcy Act compels the conclusion that the trustee must assume the second contract if he assumes the first, and there is no good reason to read such a requirement into the statute. If it is beneficial for the estate to adopt the contract with the customer, why should this benefit be sacrificed by requiring the trustee also to adopt the other contract?

In the ordinary two-party relationship, a trustee could not fairly be permitted to enforce an agreement without accepting its burdens. As applied here, this rule means that the trustee cannot require the customer to pay unless the trustee also delivers the inventory called for by the job order; *i.e.,* the trustee cannot demand payment, yet relegate the customer to a claim as an unsecured creditor for damages for breach of contract. But in a three-cornered situation, there is no comparable unfairness in allowing adoption of only one of the contracts. The trustee does not claim any benefits under the bankrupt's contract with appellant, and thus should not be compelled to undertake its burdens. He might achieve indirectly the same result for which he here contends directly, merely by proclaiming formally the rejection of all executory contracts, and then rewriting the same agreements with the customers. It would be unfortunate to require such formalism under Section 70b.

The foregoing analysis has special force on the facts of the present case. At the time appellee filled the purchase orders in question, he was unaware of the assignments to appellant. Indeed, it was not until during the litigation below that appellant asserted its blanket assignment and claimed the proceeds of deliveries of inventory after bankruptcy.[5] Thus appellee could not

---

[5]The pleading upon which appellant proceeded below was its "Second Amended Petition in Reclamation" [Tr. 20-28]. However, as late as its original "Petition in Reclamation," reproduced in material part as an Appendix to this Brief, appellant claimed only receivables generated by deliveries made by

have actually intended to assume the assignment agreements even if he had intended to assume the contracts with the customers. And the same inability would have existed even if the trustee had sought court authority to adopt executory contracts.

Almost all of the decisions cited by appellant and referred to in the preceding portion of this Brief concerned simple, two-party relationships, or cases where the claimant was a secured creditor. Thus, they are inapplicable here. But, concededly, *In re Italian Cook Oil Corp., supra,* and *In re DeLong Furniture Co., supra,* did involve assignees' claims to benefits resulting from the assumption of executory contracts. As has been seen above, however, the continued vitality of these decisions as precedents is doubtful in light of the more recent holding of the Third Circuit in the *Luscombe* case. In any event, it is submitted that they are unsound on principle and should have no persuasive effect on this appeal, since the courts there completely failed to consider the implications of the three-cornered relationship.

---

the bankrupt before bankruptcy. All invoices dated after November 1, 1960, the date of bankruptcy, were conceded by appellant to the trustee. Indeed, the three Litton Industries, Inc. invoices, now sought by appellant (see, *e.g.,* Op. Br. p. 16), were specifically admitted to belong to appellee in the original "Petition in Reclamation."

Appellant suggests that appellee knew of the assignments early in this proceeding by taking a sentence in the receiver's first operating report out of context (Op. Br. p. 4). The dispute over appellee's receivables referred to in the report concerned situations where customers made payments without designating clearly whether they pertained to pre-bankruptcy or post-bankruptcy invoices [R. p. 32]. The exhibit attached to the report in question clearly shows that the receiver did not believe that any accounts arising after November 1, 1960 were assigned [Tr. 9].

Conclusion.

For the foregoing reasons, the Order of the Honorable Harry C. Westover, United States District Judge, dated March 5, 1963, should be affirmed.

Respectfully submitted,

QUITTNER, STUTMAN, TREISTER & GLATT,
By GEORGE M. TREISTER,
Attorneys for Appellee.

Certificate.

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

GEORGE M. TREISTER

APPENDIX.

Appellant's original Petition in Reclamation is reprinted below in full, with the following exceptions:

> The verification is omitted, as are Exhibits A, B and C. The omitted exhibits are the same as those attached to, and similarly designated, in the Second Amended Petition in Reclamation [Tr. 26-28].

Petition in Reclamation.

United States District Court, Southern District of California, Central Division.

In the Matter of Conair, Inc., a California Corporation, Bankrupt. In Bankruptcy No. 117107-HW

To the Honorable Ray H. Kinnison, Referee in Bankruptcy:

The Petition of Bank of America National Trust and Savings Association, hereinafter referred to as "Petitioner", respectfully represents:

1.

That on or about November 1, 1960, Conair, Inc., a California corporation, filed a petition under Section 322 of Chapter XI of the Bankruptcy Act in the United States District Court, Southern District of California, Central Division, under the Act of Congress relating to bankruptcy.

2.

Subsequent thereto a petition for adjudication in bankruptcy was filed and the court duly appointed James A. A. Smith as Trustee in Bankruptcy for the estate of said bankrupt and said James A. A. Smith

is now qualified and is acting as such Trustee in Bankruptcy.

3.

Prior to the time of filing the said bankruptcy petition herein by bankrupt, said bankrupt on or about July 22, 1960, executed and delivered to Petitioner herein a promissory note in the amount of $109,000.00. That subsequent thereto the amount of $40,000.00 was paid off and received against that principal amount. That on September 21, 1960, said bankrupt executed and delivered a Notice of an Assignment of Accounts Receivable to the Petitioner. That said Notice of Assignment was filed with the County Recorder, County of Los Angeles, State of California, on September 22, 1960, and that bankrupt executed and delivered to Petitioner a renewal note in the amount of $69,000.00 dated September 28, 1960. A true and correct copy of said promissory note, Notice of Assignment of Account or Accounts, and Recorder's certificate of said Assignment of Accounts Receivable is attached hereto, marked Exhibits A, B and C respectively, and incorporated herein by reference. That on the dates set forth in Column 1 of Exhibit D, the bankrupt executed and delivered to Petitioner certain assignments of Accounts Receivable owed or to become owing by the entity named in Column 2 of Exhibit D. That subsequently but prior to November 1, 1960, goods manufactured by bankrupt were sold to the entities under numbered invoices as set forth in Column 3, with an invoice amount as listed in Column 4. That the net amount received from the named entities is listed in Column 5. That the total amounts received respectively by the Petitioner justly due to the Trustee and by the Trustee justly due the Petitioner are set forth in

Column 6 indicating the net difference owing to the Petitioner by the Trustee of $19,519.16. That attached to said Exhibit D are copies of the "Assignment of Monies" duly executed by said bankrupt in favor of Petitioner relating to the entities and amounts as set forth in Exhibit D.

4.

Subsequent to September 28, 1960, and prior to January 1, 1961, certain payments under said Assignment of Accounts Receivable were received by Petitioner resulting in the balance on the aforementioned renewal note, being reduced to $26,494.28, which sum is now due and owing to Petitioner. Subsequent to the appointment of James A. A. Smith as Trustee in Bankruptcy certain accounts receivable have been collected and received directly by said Trustee, the total amount being $26,730.20. That amount represents accounts receivable which were assigned to Petitioner and are properly due to Petitioner. In addition, Petitioner has collected certain sums representing accounts receivable for work done subsequent to November 1, 1960, and by agreement are properly due James A. A. Smith, Trustee in Bankruptcy. Consequently, James A. A. Smith presently holds for the estate a total of $19,519.16 net, which amount belongs to and is properly the property of said Petitioner.

5.

The Trustee in Bankruptcy, James A. A. Smith, by a letter dated December 29, 1960, advised Petitioner that in accordance with a prior understanding between Trustee and Petitioner, the Trustee requested that Petitioner make an audit of the accounts receivable, which are the subject of this Petition, and further stated that

he (Trustee) would furnish Petitioner a check in full for all accounts and monies held in trust for Petitioner in exchange for Petitioner's check for the accounts being held by Petitioner. Subsequently, by a letter dated January 16, 1961, Petitioner advised Trustee that an audit had been taken and that the result of that audit was that the Trustee had collected sums totalling $26,730.20 of accounts receivable which were assigned to Petitioner and that Petitioner had collected the sum of $7,211.04 which should be paid over to the Trustee. Petitioner by that letter requested that the net amount of $19,519.16 be forwarded to Petitioner. Petitioner has as yet received no reply to that request.

Wherefore, you [sic] Petitioner Bank of America National Trust and Savings Association prays that an order be made herein declaring that the amount of $19,519.16 is properly due the Petitioner, that said bankrupt's estate has no interest in that amount and that said Trustee be ordered to forthwith pay over to Petitioner the sum of $19,519.16.

Bank of America National Trust
and Savings Association

By L. W. Enders
Assistant Cashier

Hugo A. Steinmeyer, Robert H. Fabian
and Harris B. Taylor

By Harris B. Taylor
Attorneys for Petitioner
Bank of America National Trust
and Savings Association

Col. 1 Date	Col. 2 Payor-Entity	Col. 3 Invoice Number	Col. 3 Date	Col. 4 Invoice Amount	Col. 5 Net Amount Received	Col. 6 Net Difference
Sept. 26, 1960	Ryan Aeronautical	2641	9/23/60	$5,685.00		
		2643	9/23/60	2,751.00		
		2648	9/28/60	109.69		
		2664	9/30/60	4,070.77		
		2665	9/30/60	107.00		
		2666	9/30/60	5.00		
		DM5301	10/7/60	(682.50)		
		DM5324	10/17/60	(804.00)		
		DM5320	10/17/60	(39.00)		
		DM5323	10/17/60	(854.40)		
					$10,245.08	
Sept. 26, 1960	Convair	2705	10/14/60	1,427.44		
	Fort Worth, Texas	2730	10/24/60	1,168.01		
		2734	10/24/60	1,494.71		
					$ 4,075.90	
Sept. 26, 1960	Litton Industries	2745	10/27/60	50.00		
		2746	10/27/60	1,850.00		
		2747	10/27/60	67.06		
		2760	10/31/60	164.50		
					$ 2,131.56	
Sept. 26, 1960	Crescent-Sargent Corp.	2716	10/19/60	5,670.00	$ 5,670.00	
Sept. 26, 1960	Bell Helicopter Co.	2758	10/31/60	2,920.00	$ 2,920.00	
Sept. 26, 1960	Fort Worth General Depot	2720	10/31/60	10.61	$ 10.61	
Sept. 26, 1960	Helicopter Aircraft	2749	10/27/60	4.41	$ 4.41	
Sept. 26, 1960	Parker Aircraft Co.	2939	9/23/60	$ 385.00		
		2668	9/30/60	$ 105.40		
		2681	10/6/60	$ 124.00		
		2735	10/25/60	$ 107.00	$ 721.40	

EXHIBIT D

Col. 1 Date	Col. 2 Payor-Entity	Col. 3 Invoice Number	Col. 3 Date	Col. 4 Invoice Amount	Col. 5 Net Amount Received	Col. 6 Net Difference
Sept. 26, 1960	Monogram Precision	2647	9/28/60	$ 190.00	$ 190.00	
Sept. 26, 1960	Telecomputing Corp.	2660	9/30/60	$ 43.50		
		2667	9/30/60	$ 146.00		
		2757	10/31/60	$ 571.00	$ 760.50	
Sept. 26, 1960	Petroleum Helicopters	2702	10/14/60	$ 0.74	$ 0.74	
TOTAL AMOUNT HELD BY TRUSTEE DUE BANK						$26,730.20
Sept. 26, 1960	Ryan Aeronautical Co.	42761	11/2/60	$ 480.60		
		(502)		($47.10)		
		42792	11/15/60	$ 84.50		
		42793	11/15/60	$ 373.15		
		42794	11/15/60	$ 62.00	$ 943.61	
Sept. 26, 1960	Telecomputing Corp.	42795	11/15/60	$ 353.77	$ 350.23	
Sept. 26, 1960	Aerojet General Corp.	42770	11/8/60	$ 335.40		
		(55157)		($12.90)		
		42796	11/15/60	$ 60.25	$ 382.50	
Sept. 26, 1960	Chicago Helicopter Airways Inc.	42798	11/16/60	$ 25.72	$ 25.72	
Sept. 26, 1960	Litton Industries	42763	11/4/60	$5,700.00	$ 1,975.05	
		42779	11/10/60	$5,700.00	$ 3,385.80	
		42788	11/14/60	$ 166.25	$ 148.13	
TOTAL HELD BY BANK DUE TRUSTEE						$ 7,211.04
NET AMOUNT HELD BY TRUSTEE DUE BANK AS ASSIGNEE						$19,519.16

EXHIBIT D